

FINANCIAL STATEMENTS AND REPORT OF  
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS  
MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1  
OF DICKINSON COUNTY, KANSAS  
DECEMBER 31, 2010 AND 2009

## CONTENTS

	Page
MANAGEMENT'S DISCUSSION AND ANALYSIS	1
REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS	7
FINANCIAL STATEMENTS	
BALANCE SHEETS	9
STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS	10
STATEMENTS OF CASH FLOWS	11
NOTES TO FINANCIAL STATEMENTS	13

# MEMORIAL HEALTH SYSTEM

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2010 and 2009

Our discussion and analysis of the financial performance of Memorial Health System provides a narrative overview of the Health System's financial activities for the years ended December 31, 2010 and 2009. The analysis described in the following paragraphs for Memorial Health System refers to the column labeled "Hospital" in the financial statements. The column labeled "Component unit" refers to Abilene Housing Inc. and is not considered in the calculations made in the following paragraphs because it is legally separate from the hospital. Please read this analysis in conjunction with the accompanying basic financial statements.

### Abilene Housing Inc. (Frontier Estates)

Abilene Housing Inc. was added to Memorial Health System's family of services on June 1, 2004. It is presented as a "Component unit" on the accompanying financial statements because it is a separate legal entity. The 2010 financial statements of Abilene Housing Inc. were audited by an accounting firm different from the Health System's auditors, therefore, the Health System's auditors, Wendling, Noe, Nelson, and Johnson LLC, do not express an opinion on the audit of Abilene Housing Inc. Reese & Novelly, P.A, performed the 2010 and 2009 audit of Abilene Housing Inc.

### Financial highlights

The Health System's net assets increased during each of the past two years with a \$1,064,196 or 6.9% increase in 2010 and a \$675,082 or 4.6% increase in 2009.

The Health System's total operating revenue increased during each of the past two years with a \$600,817 or 3.1% increase in operating revenue for 2010 and a \$1,180,979 or 6.5% increase in operating revenue for 2009.

The hospital became designated as a Critical Access Hospital (CAH) effective December 16, 2005. This classification change increased the 2006 and subsequent years total operating revenue due to contractual adjustments being reduced for Medicare related patients. During 2009, Memorial Health System secured the consulting services of Stroudwater Associates who calculated the CAH annual impact on the income statement to be an increase in net patient services revenue of approximately \$950,000.

Memorial Health System  
Management's Discussion and Analysis – Continued  
Years Ended December 31, 2010 and 2009

Using these financial statements

The Health System's financial statements consist of three statements – (1) a Balance Sheet; (2) a Statement of Revenue, Expenses, and Changes in Net Assets; and (3) a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Health System, including resources held by or for the benefit of the Health System, and resources restricted for specific purposes by contributors, grantors, and indenture agreements.

One of the most important questions asked about the Health System's finances is, "Is the Health System as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the Health System's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. For purposes of these two statements, revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Health System's net assets and changes in them. The Health System's net assets – the difference between assets and liabilities – may be thought of as one way to measure its financial health, or financial position. Over time, increases or decreases in the Health System's net assets are one indicator of whether its financial health is improving or deteriorating. Consideration must also be given to other nonfinancial indicators, such as changes in the Health System's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Health System.

The final required statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balances during the reporting period?"

Memorial Health System  
Management's Discussion and Analysis – Continued  
Years Ended December 31, 2010 and 2009

Assets, liabilities, and net assets

The Health System's balance sheets as of the end of each of the last three years are summarized as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets			
Current assets	\$4,156,195	\$4,326,235	\$2,746,922
Assets limited as to use	0	141,837	135,728
Capital assets, net	7,413,922	7,289,265	7,688,269
Other assets	19,364	19,414	0
Other investments	<u>6,078,296</u>	<u>5,170,688</u>	<u>5,740,006</u>
Total assets	<u>\$17,667,777</u>	<u>\$16,947,439</u>	<u>\$16,310,925</u>
Liabilities			
Long-term obligations	\$ 0	\$ 0	\$150,000
Agency funds	19,414	19,414	0
Current liabilities	<u>1,164,864</u>	<u>1,508,722</u>	<u>1,416,704</u>
Total liabilities	<u>\$ 1,184,278</u>	<u>\$1,528,136</u>	<u>\$1,566,704</u>
Net assets	<u>\$16,483,499</u>	<u>\$15,419,303</u>	<u>\$14,744,221</u>

Cash and invested cash in the current asset category decreased by \$268,653 in 2010 and increased by \$444,259 during 2009. Although the cash balance is small for an organization with over \$17,500,000 in assets, significant additional cash is available in other investments and is held in money market accounts, certificates of deposit, and marketable securities and is readily available for day-to-day operating cash flow needs.

Assets whose use is limited by board and other investments increased by \$765,771 in 2010 and decreased by \$563,209 in 2009. The increase of other investments in 2010 was a result of profitable operations in 2010 as well as non-operating revenues in 2010. A significant portion of the decrease in 2009 (\$444,259) was due to an increase in cash and invested cash.

In aggregate, the Health System's unrestricted cash, restricted cash, and investments total \$6,374,413 and \$5,877,295 as of December 31, 2010 and 2009, respectively. This represents 127 and 118 days, respectively, of average cash expenses during each of the years then ended. These cash ratio values are higher than median values for other rural CAH hospitals and higher than the average of all Kansas hospitals as reported by Ingenix.

The Health System's net patient accounts receivable were 68.3% of current assets as of December 31, 2010, 60.3% of current assets as of December 31, 2009, and 72.2% of current

Memorial Health System  
Management's Discussion and Analysis – Continued  
Years Ended December 31, 2010 and 2009

assets as of December 31, 2008. The average number of days in accounts receivable of net patient revenue was 55 days, 52 days, and 42 days as of December 31, 2010, 2009, and 2008, respectively.

At the end of 2010, the Health System had \$7,413,922 invested in capital assets, net of accumulated depreciation. Net capital assets increased in 2010 by \$124,657. This increase in net capital assets includes the purchase of facilities and equipment of an existing family practice clinic in the amount of \$564,536. At the end of 2009, the Health System had \$7,289,265 invested in capital assets, net of accumulated depreciation. Net capital assets decreased in 2009 by \$399,004 as new capital purchases were made at a lesser rate than depreciation expense taken in 2009. The Health System is planning for a significant expansion of facilities in the next few years and therefore has chosen to hold off on some improvements resulting in replacements of capital purchases being less than depreciation taken on existing facilities and existing equipment.

No new long-term obligations were incurred during 2009 or 2010. All capital purchases in 2009 and 2010 were paid with cash. The annual principal payment on the bond issue was paid per the schedule of \$150,000 in 2010 and \$140,000 in 2009. The bond issue was paid off in full per schedule in April 2010 and there is no outstanding bond indebtedness.

The Health System's net assets increased during each of the past two years (\$1,064,196 or 6.9% during 2010 and \$675,082 or 4.6% during 2009), primarily due to profitable operations after including non-operating revenues and contributions to capital. The percentage of total assets financed with net assets, or equity, was 93.3%, 91.0%, and 90.4%, as of December 31, 2010, 2009, and 2008 respectively. The percentage increase in 2009 and 2010 was due to profitable operations after including non-operating revenues. All capital purchases in 2009 and 2010 were paid for with cash without incurring any additional long-term debt as well as no capital lease liabilities were incurred.

Memorial Health System  
Management's Discussion and Analysis – Continued  
Years Ended December 31, 2010 and 2009

Operating results and changes in net asset

The Health System's operating results and changes in net assets for each of the last three years are summarized as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Operating revenues	\$19,839,419	\$19,238,602	\$18,057,623
Operating expenses	<u>19,334,949</u>	<u>19,329,863</u>	<u>18,008,057</u>
Operating income (loss)	<u>504,470</u>	<u>(91,261)</u>	<u>49,566</u>
Interest expense	\$ 1,932	\$ 16,021	\$ 24,373
Nonoperating revenues	545,773	784,224	369,099
Gain (Loss) on disposal of capital assets	0	(37,176)	328
Capital grants and contributions	<u>15,885</u>	<u>35,316</u>	<u>25,535</u>
Increase in net assets	<u>\$1,064,196</u>	<u>\$675,082</u>	<u>\$420,155</u>

The first, and most significant, component of the overall change in the Health System's net assets is its operating income – generally, the difference between net patient service revenue and the expenses incurred to perform these services. The hospital became designated a Critical Access Hospital (CAH) effective December 16, 2005. This classification change increased the total operating revenue due to contractual adjustments being reduced for Medicare related patients. The financial impact of being designated a CAH was a positive annual amount of approximately \$950,000 as calculated by Stroudwater Associates, a consultant hired by the Health System.

Net patient service revenue is analyzed as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Inpatient services	\$13,140,332	\$12,863,346	\$13,076,108
Outpatient services	<u>17,381,806</u>	<u>16,163,543</u>	<u>13,967,120</u>
Gross patient service revenue	<u>\$30,522,138</u>	<u>\$29,026,889</u>	<u>\$27,043,228</u>
Contractual adjustments	\$10,914,652	\$10,025,543	\$9,195,503
Provision for bad debts	546,569	505,207	554,954
Charity Care	<u>187,982</u>	<u>215,597</u>	<u>198,708</u>
Net patient service revenue	<u>\$18,872,935</u>	<u>\$18,280,542</u>	<u>\$17,094,063</u>

Beginning in 2008 and forward thru 2010, the Health System experienced outpatient charges being more than 50% of total patient charges. For 2008, the outpatient charges represented 51.6% of total patient services charges, 55.7% for 2009, and 56.9% for 2010. In recent past years, the Health System grew its inpatient services due primarily to the purchase of a long term care facility on February 1, 2003 and the resulting growth of long term care services. However, beginning with 2008, the trend toward outpatient services was more pronounced and increased at

Memorial Health System  
Management's Discussion and Analysis – Continued  
Years Ended December 31, 2010 and 2009

a higher rate than in the past for the Health System. This is consistent with what is happening in the health care industry.

Effective January 1, 2008 the hospital increased its acute care room rate by 4.4%. Ancillary rates were increased in various percentages depending on the respective department. Effective January 1, 2009, the hospital increased its most prevalent acute care room rate, (semi-private acute care) by 5.6%. Ancillary rates were increased effective February 1, 2009 by various percentages depending on the respective department. Effective January 1, 2010, the hospital increased its most prevalent acute care room rate, (semi-private acute care) by 8.0%.

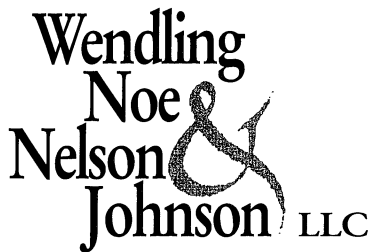
The Health System has agreements with various third-party payors that provide for payments to the Health System at amounts different from its established charge rates. These differences are referred to as contractual adjustments. Contractual adjustments continue to be a significant portion of the reduction in gross patient services revenue and have represented 35.8% of charges for 2010, 34.5% of charges for 2009, and 34.0% of charges for 2008.

The Health System provides care free of charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Charity care write-offs have generally increased because the Health System has been more aggressively identifying qualifying patients; however charity care decreased by approximately \$27,000 in 2010 compared to 2009 and increased by approximately \$17,000 in 2009 compared to 2008. There is a growing trend in the health care industry to identify and report the value of charity care provided to patients. The Health System identified and provided charity care in the amount of \$187,982 for 2010, \$215,597 for 2009, and \$198,708 for 2008. The provision for bad debts represented 1.79%, 1.74%, and 2.05% of gross patient service revenue during 2010, 2009, and 2008, respectively.

Employee salaries and wages increased by \$357,762 or 3.6% during 2010 and \$731,323 or 8.0% during 2009. The health system implemented pay raises commensurate with market conditions for 2010 and 2009. Supplies and other expenses increased during 2009 and decreased during 2010. The net increase in these expenses was \$551,193 in 2009 or 7.1% and decrease of \$280,595 in 2010 or 3.4%.

In summary, operating revenue increased by \$600,817 or 3.1% in 2010 while operating expenses increased by \$5,086 or 0.0% in 2010. This increase in operating revenue in 2010 while holding expense to a 0.0% increase resulted in an operating gain of \$504,470 which is the best operating result in the history of the organization when stated in dollar values.





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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors  
Memorial Hospital of Hospital District #1  
of Dickinson County, Kansas

We have audited the accompanying financial statements of the business-type activity and discretely presented component unit of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas, as of and for the years ended December 31, 2010 and 2009, which collectively comprise the Hospital's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the 2010 and 2009 financial statements of Abilene Housing, Inc., a discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the 2010 and 2009 amounts included for Abilene Housing, Inc., is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activity and discretely presented component unit of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas, as of December 31, 2010 and 2009, and their respective results of operations, changes in net assets, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 1 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Wendling Roe Nelson & Johnson LLC

Topeka, Kansas  
April 20, 2011

FINANCIAL STATEMENTS

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

BALANCE SHEETS

December 31,

ASSETS

	2010		2009	
	Hospital	Component unit	Hospital	Component unit
CURRENT ASSETS				
Cash and invested cash	\$ 296,117	\$ 116,647	\$ 564,770	\$ 108,023
Investments		32,489		32,161
Patient accounts receivable, net of allowance for doubtful accounts of \$606,277 in 2010 and \$365,124 in 2009	2,839,801		2,610,564	
Accounts receivable - other	86,019		269,485	
Interest receivable	34,457		34,927	
Estimated settlements due from third-party payors	302,000		225,000	
Assets whose use is limited by bond resolution - required for current liabilities			111,341	
Inventories	282,207		292,461	
Prepaid expenses	315,594	13,009	217,687	12,536
Total current assets	4,156,195	162,145	4,326,235	152,720
ASSETS WHOSE USE IS LIMITED				
By Board of Directors		32,541	141,837	22,583
By bond resolution			111,341	
Tenant security deposits		24,097		24,423
	-	56,638	253,178	47,006
Less amounts required for current liabilities			111,341	
Noncurrent assets whose use is limited	-	56,638	141,837	47,006
OTHER INVESTMENTS	6,078,296	87,077	5,170,688	85,434
CAPITAL ASSETS - NET	7,413,922	804,982	7,289,265	846,442
OTHER ASSETS	19,364	1,571	19,414	1,772
	<u>\$17,667,777</u>	<u>\$1,112,413</u>	<u>\$16,947,439</u>	<u>\$1,133,374</u>

The accompanying notes are an integral part of these statements.

# LIABILITIES AND NET ASSETS

	2010		2009	
	Hospital	Component unit	Hospital	Component unit
CURRENT LIABILITIES				
Accounts payable	\$ 344,265	\$ 11,146	\$ 672,942	\$ 11,079
Accrued salaries, wages, and related withholding taxes payable	432,004	3,568	348,906	2,030
Accrued vacation pay	365,515		317,255	
Accrued interest payable		3,923	3,688	4,272
Current installments of long-term debt		71,341	150,000	67,029
Current portion of deferred revenue	23,080		15,931	
Total current liabilities	<u>1,164,864</u>	<u>89,978</u>	<u>1,508,722</u>	<u>84,410</u>
LONG-TERM DEBT, excluding current installments	<u>-</u>	<u>681,937</u>	<u>-</u>	<u>753,280</u>
DEFERRED REVENUE, excluding current portion	<u>-</u>	<u>19,051</u>	<u>-</u>	<u>18,833</u>
AGENCY FUNDS	<u>19,414</u>	<u>-</u>	<u>19,414</u>	<u>-</u>
NET ASSETS				
Invested in capital assets - net of related debt	7,413,922	51,704	7,139,265	26,133
Restricted for debt service			111,341	
Unrestricted	<u>9,069,577</u>	<u>269,743</u>	<u>8,168,697</u>	<u>250,718</u>
Total net assets	<u>16,483,499</u>	<u>321,447</u>	<u>15,419,303</u>	<u>276,851</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 17,667,777</u>	<u>\$ 1,112,413</u>	<u>\$ 16,947,439</u>	<u>\$ 1,133,374</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS

Year ended December 31,

	2010		2009	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
Operating revenues				
Net patient service revenue	\$ 18,872,935	\$ -	\$ 18,280,542	\$ -
Other	<u>966,484</u>	<u>451,376</u>	<u>958,060</u>	<u>435,149</u>
Total operating revenues	<u>19,839,419</u>	<u>451,376</u>	<u>19,238,602</u>	<u>435,149</u>
Operating expenses				
Salaries and wages	10,264,780	57,137	9,907,018	53,463
Supplies and other	7,994,389	252,229	8,274,984	240,903
Depreciation and amortization	<u>1,075,780</u>	<u>72,867</u>	<u>1,147,861</u>	<u>72,759</u>
Total operating expenses	<u>19,334,949</u>	<u>382,233</u>	<u>19,329,863</u>	<u>367,125</u>
Operating income (loss)	<u>504,470</u>	<u>69,143</u>	<u>(91,261)</u>	<u>68,024</u>
Nonoperating revenues (expenses)				
Tax levy	268,260		270,833	
Contributions	131,122	21,173	159,636	22,149
Investment income	146,391	3,301	353,755	8,551
Interest expense	(1,932)	(49,021)	(16,021)	(52,838)
Loss on disposal of assets			(37,176)	(1,467)
Nonoperating revenues (expenses), net	<u>543,841</u>	<u>(24,547)</u>	<u>731,027</u>	<u>(23,605)</u>
Excess of revenues over expenses before capital contributions	1,048,311	44,596	639,766	44,419
Capital contributions	<u>15,885</u>		<u>35,316</u>	
Increase in net assets	1,064,196	44,596	675,082	44,419
Net assets at beginning of year	<u>15,419,303</u>	<u>276,851</u>	<u>14,744,221</u>	<u>232,432</u>
Net assets at end of year	<u>\$ 16,483,499</u>	<u>\$ 321,447</u>	<u>\$ 15,419,303</u>	<u>\$ 276,851</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

STATEMENTS OF CASH FLOWS

Year ended December 31,

	2010		2009	
	Hospital	Component unit	Hospital	Component unit
Cash flows from operating activities				
Receipts from and on behalf of patients	\$ 18,767,736	\$ -	\$ 17,100,234	\$ -
Payments to or on behalf of employees	(10,133,422)	(55,599)	(9,741,537)	(54,512)
Payments to suppliers	(8,360,000)	(252,635)	(8,202,896)	(233,155)
Other receipts and payments	<u>1,107,620</u>	<u>451,594</u>	<u>849,046</u>	<u>436,688</u>
Net cash provided by operating activities	<u>1,381,934</u>	<u>143,360</u>	<u>4,847</u>	<u>149,021</u>
Cash flows from noncapital financing activities				
Tax levy	268,260		270,833	
Noncapital contributions	<u>140,637</u>	<u>21,173</u>	<u>151,076</u>	<u>22,149</u>
Net cash provided by noncapital financing activities	<u>408,897</u>	<u>21,173</u>	<u>421,909</u>	<u>22,149</u>
Cash flows from capital and related financing activities				
Purchase of capital assets	(1,251,156)	(31,206)	(747,350)	(31,412)
Contributions for purchase of capital assets	47,193		4,008	
Repayment of long-term debt	(150,000)	(67,031)	(140,000)	(63,415)
Interest paid	<u>(5,620)</u>	<u>(49,370)</u>	<u>(16,500)</u>	<u>(52,985)</u>
Net cash used by capital and related financing activities	<u>(1,359,583)</u>	<u>(147,607)</u>	<u>(899,842)</u>	<u>(147,812)</u>
Cash flows from investing activities				
Decrease (increase) in assets whose use is limited by bond resolution	111,341		(5,173)	
Decrease (increase) in assets whose use is limited by Board of Directors	141,837	(9,958)	(6,109)	(9,837)
Decrease (increase) in assets whose use is limited - tenant security deposits		326		(838)
(Increase) decrease in investments	(897,165)	(1,165)	744,689	(1,907)
Decrease in other assets	50			
Purchase of physician practice	(192,382)			
Investment income	<u>136,418</u>	<u>2,495</u>	<u>183,938</u>	<u>3,107</u>
Net cash provided (used) by investing activities	<u>(699,901)</u>	<u>(8,302)</u>	<u>917,345</u>	<u>(9,475)</u>

The accompanying notes are an integral part of these statements.

## MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

## STATEMENTS OF CASH FLOWS - CONTINUED

Year ended December 31,

	2010		2009	
	Hospital	Component unit	Hospital	Component unit
Net change in cash and cash equivalents	(268,653)	8,624	444,259	13,883
Cash and cash equivalents at beginning of year	<u>564,770</u>	<u>108,023</u>	<u>120,511</u>	<u>94,140</u>
Cash and cash equivalents at end of year	<u>\$ 296,117</u>	<u>\$ 116,647</u>	<u>\$ 564,770</u>	<u>\$ 108,023</u>
Reconciliation of operating income (loss) to net cash provided by operating activities				
Operating income (loss)	\$ 504,470	\$ 69,143	\$ (91,261)	\$ 68,024
Adjustments to reconcile operating income (loss) to net cash provided by operating activities				
Depreciation and amortization	1,075,780	72,867	1,147,861	72,759
(Decrease) increase in deferred revenue	(3,305)	218	1,009	1,539
Provision for bad debts	546,569		505,207	
Changes in				
Patient and other accounts receivable	(430,327)		(1,241,538)	
Inventories and prepaid expenses	(87,653)	(473)	(142,796)	823
Accounts payable and accrued expenses	(146,600)	1,605	380,365	5,876
Estimated settlements due from third-party payors	<u>(77,000)</u>		<u>(554,000)</u>	
Net cash provided by operating activities	<u>\$ 1,381,934</u>	<u>\$ 143,360</u>	<u>\$ 4,847</u>	<u>\$ 149,021</u>

The accompanying notes are an integral part of these statements.



MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS

December 31, 2010 and 2009

NOTE A - SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

1. Financial reporting entity

Memorial Hospital of Hospital District #1 of Dickinson County, Kansas (Hospital), is a municipal corporation operating an acute-care hospital located in Abilene, Kansas, with a licensed bed capacity of 25 acute care beds and 10 psychiatric beds and a long-term care facility with a licensed bed capacity of 75 beds. The Hospital is governed by an elected five-member Board of Directors.

On November 1, 2010, the Hospital purchased substantially all of the assets of a physician practice located in Abilene, Kansas. Purchased assets included a medical office building, medical equipment, patient accounts receivable, and medical records. The Hospital is operating the physician practice under the business name of Heartland Health Care Clinic.

2. Component unit

The financial statements include the financial data of the discretely presented component unit described below. The component unit is reported separately to emphasize that it is legally separate from the Hospital.

Abilene Housing, Inc. (AHI), was formed and organized as a Kansas not-for-profit corporation. AHI provides housing for elderly and handicapped persons in a 60-unit apartment project located in Abilene, Kansas, and provides services specifically designed to meet the physical, social, and psychological needs of those individuals. Effective June 1, 2004, membership of AHI's Board consists of one member of the Board of Directors of the Hospital, the Chief Executive Officer of the Hospital, the Chief Financial Officer, Chief Operating Officer, or Chief Nursing Officer of the Hospital and, before June 2009, one member elected by an Advisory Board to AHI. Before June 1, 2004, AHI's Board membership was independent of the Hospital Board and officers.

Financial data of AHI are presented as of and for the years ended September 30, 2010 and 2009. Separate financial statements for AHI are not available for public distribution.

3. Basis of accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Accounting," the Hospital has implemented all GASB pronouncements, and Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued before November 30, 1989, except those that conflict with GASB pronouncements and has elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

4. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

5. Patient accounts receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payors, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

6. Inventories

Inventories are stated at cost as determined on the first-in, first-out method.

7. Investments in debt and equity securities

Investments in debt and equity securities are carried at fair value. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating investment income.

8. Capital assets

Capital assets are stated at cost. Depreciation and amortization of capital assets is provided on the straight-line method over the estimated useful lives of the assets. The estimated lives used are generally in accordance with the guidelines established by the American Hospital Association.

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the item or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

9. Net assets

Net assets are classified in three components. "Net assets invested in capital assets net of related debt" consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted net assets" are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital. "Unrestricted net assets" are remaining net assets that do not meet the definition of "invested in capital assets net of related debt" or "restricted."

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

10. Operating revenues and expenses

The statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Hospital's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

11. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, the provision for bad debts, and contractual adjustments, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

12. Charity care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

13. Tax levy

The Hospital receives financial support from ad valorem taxes. Ad valorem taxes are assessed in November of each year and are available for use by the Hospital in the following year.

14. Income taxes

The Hospital is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code. AHI operates under Section 501(c)(3) of the Internal Revenue Code and is generally exempt from federal and state income taxes.

15. Cash equivalents

All cash and invested cash, excluding assets whose use is limited and investments, are considered to be cash equivalents.

16. Reclassifications

Certain reclassifications have been made to the 2009 financial statements to conform to the 2010 presentation.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE B - ASSETS WHOSE USE IS LIMITED BY BOARD OF DIRECTORS

Assets whose use is limited by Board of Directors consist of invested cash to be used for replacement of capital assets or for the purchase of additional capital assets. The funds may be used for other purposes by action of the Board of Directors.

NOTE C - ASSETS WHOSE USE IS LIMITED BY BOND RESOLUTION

Assets whose use is limited by bond resolution consist of required accounts to be maintained by the Hospital under the terms of the Hospital Revenue Bond, Series 1990, resolution (see Note H). Funds held in these accounts consist of invested cash and are summarized as follows:

	<u>2010</u>	<u>2009</u>
Principal and interest account	\$ -	\$ 111,341
Less amounts required for current liabilities		<u>111,341</u>
	<u>\$ -</u>	<u>\$ -</u>

Under the terms of the bond resolution, the principal and interest account is to be used for payment of principal and interest on the Revenue Bonds.

NOTE D - INVESTMENTS

Investments are summarized as follows:

	<u>2010</u>		<u>2009</u>	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
Invested cash consisting of bank certificates of deposit, bank savings account and money market mutual fund	\$3,695,440	\$ 32,489	\$2,907,949	\$ 32,161
Common stock at fair value	14,782		29,278	
Equity in undistributed earnings of Mobile Clinical Services, Inc.	86,090		121,771	
Corporate bonds at fair value	2,128,775		2,024,601	59,500
Mutual funds at fair value	147,003	87,077	80,425	25,934
Interest receivable			1,148	
Abilene Community Foundation Endowment fund	<u>6,206</u>		<u>5,516</u>	
	<u>\$6,078,296</u>	<u>\$ 119,566</u>	<u>\$5,170,688</u>	<u>\$ 117,595</u>

The Hospital received contributions from an outside trust consisting of common stock and corporate bonds. The outside trustee stipulated that the Hospital board administer the resources created by the contributions separate from

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE D - INVESTMENTS - Continued

public monies held by the Hospital and that the assets be invested with the goal of maximizing the benefit to the Hospital by retaining the securities in their existing form through their maturities and placing the assets in similar high-grade securities in the future. Restrictions on the use of the contributions have been met and the investments are now unrestricted as to their use by the Hospital.

In 2005, the Hospital acquired a 20 percent ownership interest in Mobile Clinical Services, Inc., (MCSI). The Hospital's equity in undistributed net earnings of MCSI since acquisition is \$86,090. Nuclear medicine and ultrasound services are provided to the Hospital through arrangements with MCSI. Total fees charged to operating expense for these services were approximately \$83,000 in 2010 and \$125,000 in 2009. Amounts payable to MCSI for these services were insignificant at December 31, 2010 and 2009.

NOTE E - CAPITAL ASSETS

Hospital capital asset additions, retirements, and balances are as follows:

	2010		
	Beginning balance	Additions/ transfers	Ending balance
Land	\$ 658,828	\$ 131,655	\$ -
Land improvements	742,932		742,932
Buildings	11,430,184	278,549	153,419
Major movable equipment	5,773,276	495,311	22,622
Totals at historical cost	18,605,220	905,515	176,041
Less accumulated depreciation			
Land improvements	276,506	30,348	306,854
Buildings	7,042,186	528,875	153,419
Major movable equipment	4,145,814	516,557	22,622
Total accumulated depreciation	11,464,506	1,075,780	176,041
Construction in progress and planning costs	148,551	294,922	-
Capital assets, net	<u>\$ 7,289,265</u>	<u>\$ 124,657</u>	<u>\$ -</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE E - CAPITAL ASSETS - Continued

	2009			
	Beginning balance	Additions/ transfers	Retirements	Ending balance
Land	\$ 658,828	\$ -	\$ -	\$ 658,828
Land improvements	634,124	114,821	6,013	742,932
Buildings	11,935,440	56,728	561,984	11,430,184
Major movable equipment	8,054,547	616,357	2,897,628	5,773,276
Totals at historical cost	21,282,939	787,906	3,465,625	18,605,220
Less accumulated depreciation				
Land improvements	238,577	43,942	6,013	276,506
Buildings	7,056,333	520,640	534,787	7,042,186
Major movable equipment	6,450,184	583,279	2,887,649	4,145,814
Total accumulated depreciation	13,745,094	1,147,861	3,428,449	11,464,506
Construction in progress and planning costs	150,424	(1,873)	-	148,551
Capital assets, net	<u>\$ 7,688,269</u>	<u>\$ (361,828)</u>	<u>\$ 37,176</u>	<u>\$ 7,289,265</u>

Construction in progress and planning costs consist mainly of design and planning costs for a building addition and renovation.

AHI capital asset additions, retirements, and balances are as follows:

	2010			
	Beginning balance	Additions/ transfers	Retirements	Ending balance
Land	\$ 106,881	\$ -	\$ -	\$ 106,881
Building and improvements	1,331,918	13,970		1,345,888
Furniture and equipment	493,082	17,236	519	509,799
Totals at historical cost	1,931,881	31,206	519	1,962,568
Less accumulated depreciation				
Building and improvements	828,345	26,996		855,341
Furniture and equipment	257,094	45,670	519	302,245
Total accumulated depreciation	1,085,439	72,666	519	1,157,586
Capital assets, net	<u>\$ 846,442</u>	<u>\$ (41,460)</u>	<u>\$ -</u>	<u>\$ 804,982</u>

## MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

## NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

## NOTE E - CAPITAL ASSETS - Continued

	2009			
	<u>Beginning balance</u>	<u>Additions/ transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 106,881	\$ -	\$ -	\$ 106,881
Building and improvements	1,331,918			1,331,918
Furniture and equipment	<u>710,646</u>	<u>31,412</u>	<u>248,976</u>	<u>493,082</u>
Totals at historical cost	<u>2,149,445</u>	<u>31,412</u>	<u>248,976</u>	<u>1,931,881</u>
Less accumulated depreciation				
Building and improvements	801,629	26,716		828,345
Furniture and equipment	<u>459,077</u>	<u>45,526</u>	<u>247,509</u>	<u>257,094</u>
Total accumulated depreciation	<u>1,260,706</u>	<u>72,242</u>	<u>247,509</u>	<u>1,085,439</u>
Capital assets, net	<u>\$ 888,739</u>	<u>\$ (40,830)</u>	<u>\$ 1,467</u>	<u>\$ 846,442</u>

## NOTE F - REIMBURSEMENT PROGRAMS

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established charge rates. The amounts reported on the balance sheets as estimated settlements due from third-party payors consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services.

A summary of the payment arrangements with major third-party payors follows:

Medicare - Inpatient and outpatient acute care services and skilled nursing swing-bed services rendered to Medicare program beneficiaries are paid under the provisions applicable to critical access hospitals. Geriatric psychology services are paid based on prospectively determined per diem rates.

Payments to the Hospital under the critical access hospital provisions are based on various cost reimbursement methodologies. Physician services and skilled nursing services, provided at the Hospital's long-term care facility, rendered to Medicare beneficiaries are paid based on prospectively determined rates. The Hospital is paid for cost reimbursable items at a tentative rate with the final settlement determined after submission of annual cost reports by the Hospital and audits or reviews thereof by the Medicare fiscal intermediary. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Hospital's Medicare cost reports have been audited or reviewed by the Medicare fiscal intermediary through December 31, 2008.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE F - REIMBURSEMENT PROGRAMS - Continued

Medicaid - Acute care services rendered to Medicaid beneficiaries, other than those covered under HMO plans, are paid under provisions applicable to critical access hospitals. Payments to the Hospital under the critical access hospital provisions are based on cost reimbursement methodologies used by the Medicare program. Final settlement with the Medicaid program is based on the cost report submitted and settled upon by the Medicare program.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross-Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

The Hospital has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

A summary of gross and net patient service revenue follows:

	<u>2010</u>	<u>2009</u>
Gross patient service revenue	\$ 30,522,138	\$ 29,026,889
Adjustments to patient service revenue		
Third-party contractual adjustments, discounts, and allowances	(10,914,652)	(10,025,543)
Provision for bad debts	(546,569)	(505,207)
Charity care	(187,982)	(215,597)
Net patient service revenue	<u>\$ 18,872,935</u>	<u>\$ 18,280,542</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 42 percent and 11 percent, respectively, of the Hospital's net patient service revenue during 2010, and 42 percent and 11 percent, respectively, of the Hospital's net patient service revenue during 2009. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

NOTE G - DEFERRED REVENUE

The Hospital and AHI received certain payments in advance of the performance of services. These payments are reflected as deferred revenue.



MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE H - LONG-TERM DEBT

Hospital long-term debt consists of the following:

	<u>2010</u>	<u>2009</u>
7.5% Hospital Revenue Bonds, Series 1990, issued on May 1, 1990, in the original amount of \$1,650,000	\$ -	\$ 150,000
Less current installments	<u>          </u>	<u>150,000</u>
	<u>\$ -</u>	<u>\$ -</u>

The Hospital Revenue Bonds were issued to partially fund an expansion and remodeling of the Hospital facilities and the purchase of equipment. Bond principal is due in annual installments of varying amounts on May 1 of each year with final maturity on May 1, 2010, and interest is payable semiannually on May 1 and November 1 of each year. The bonds are secured by a pledge of the net revenues derived from the operations of the Hospital.

The following is a summary of changes in long-term debt:

Principal outstanding at January 1, 2009	\$ 290,000
2009 payment of debt	<u>(140,000)</u>
Principal outstanding at December 31, 2009	\$ 150,000
2010 payment of debt	<u>(150,000)</u>
Principal outstanding at December 31, 2010	<u>\$ -</u>

The provisions of the bond resolution contain covenants which, among other covenants, require the establishment and maintenance of certain accounts (see Note C), require the Hospital to set charge rates for Hospital services at such levels so that net revenues of the Hospital will not be less than 125 percent of the debt service requirement, and place restrictions on the mortgage or sale of the Hospital facilities.

A comparison of net revenues and debt service requirement, as defined by the bond resolution, for the year ended December 31, 2010, are as follows:

Net revenues	<u>\$ 13,775,226</u>
Debt service requirement	<u>\$ 155,625</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE H - LONG-TERM DEBT - Continued

Also, the bond resolution requires the Hospital to carry and maintain certain insurance coverage. A summary of insurance coverage in effect at December 31, 2010, is as follows:

<u>Insurer/coverage</u>	<u>Policy expiration date</u>	<u>Coverage amount</u>	<u>Policy premium amount</u>
Employers Mutual Insurance	1-01-11		\$ 44,359
Property			
Blanket building and contents		\$38,769,486	
Valuable papers		50,000	
Property in transit		10,000	
Business income and extra expense		4,100,000	
Commercial auto liability		500,000	
Cincinnati Insurance Company	1-01-11		15,648
Boiler and machinery coverage		16,000,000	
Crime			
Blanket employee dishonesty		100,000	
Nonemployee forgery and alteration		50,000	
Money and securities		2,000	
Directors and officers liability		1,000,000	
National Union Fire Insurance Company	9-24-11		350
Accident insurance protection		250,000	
Cincinnati Insurance Company	2-01-11		200
Resident fund		15,000	
KaMMCO	1-01-11		55,277
General liability			
Personal injury and property			
damage		1,000,000/ 3,000,000	
Employee benefit		250,000	
Professional liability			
Basic coverage		200,000/ 600,000	
Health care stabilization			
fund coverage		300,000/ 900,000	
Allied professional employees			
liability		1,000,000/ 3,000,000	
KHA Workers' Compensation			
Fund, Inc.	1-01-11		126,796
Workman's compensation		Statutory	
Employer's liability		500,000	

Prior to November 15, 2008, AHI long-term debt consisted of a 6 percent mortgage loan with a bank issued on November 20, 2003. This loan was refinanced on November 15, 2008, with a 6.25 percent mortgage loan with a bank. Monthly installments of principal and interest are \$9,700 with a final payment of \$520,931 due on November 15, 2013. The mortgage loan is collateralized by AHI's apartment project.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE H - LONG-TERM DEBT - Continued

The following is a schedule of long-term debt maturities:

<u>Years ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 71,341	\$ 45,059	\$ 116,400
2012	75,929	40,471	116,400
2013	80,813	35,587	116,400
2014	<u>525,195</u>	<u>5,435</u>	<u>530,630</u>
	<u>\$ 753,278</u>	<u>\$ 126,552</u>	<u>\$ 879,830</u>

The following is a summary of changes in long-term debt:

Principal outstanding at October 1, 2008	\$ 883,724
2009 payment of debt	<u>(63,415)</u>
Principal outstanding at September 30, 2009	820,309
2010 payment of debt	<u>(67,031)</u>
Principal outstanding at September 30, 2010	<u>\$ 753,278</u>

NOTE I - LEASES

The Hospital leases property and equipment under operating lease arrangements. Total lease expense under all operating leases was approximately \$17,000 for 2010 and \$12,000 for 2009.

NOTE J - RISK MANAGEMENT

The Hospital is insured for professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Hospital is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$300,000 pursuant to any one judgment or settlement against the Hospital for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$900,000. All coverage is on a claims-made basis. The above policies have been renewed through January 1, 2012. The Hospital intends to renew this coverage on that date and is aware of no reason why such coverage would be denied at that time.

In addition to the risk disclosed elsewhere in these financial statements and notes thereto, the Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Hospital purchases commercial insurance for these risks.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE K - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize the Hospital, with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, the State Treasurer's municipal investment pool, and U.S. Treasury bills and notes. Also, statutes generally require that financial institutions pledge securities with a market value equal to total deposits, except for monies acquired through the receipt of grants, donations, bequests, and gifts, in excess of F.D.I.C. coverage at any given time and the securities pledged be deposited with a Kansas state or national bank or trust company, the Federal Reserve Bank, the Federal Home Loan Bank, or the Kansas State Treasurer.

The carrying amount of the Hospital's deposits with financial institutions was \$3,353,192 and the bank balances were \$3,564,660 at December 31, 2010. The bank balances are categorized as follows at December 31, 2010:

Amount insured by the F.D.I.C., or collateralized with securities held by the Hospital or by its agent in the Hospital's name	\$ 859,773
Uncollateralized (amount collateralized with securities held in safekeeping by an authorized depository other than the pledging financial institution's trust department, but not in the Hospital's name)	<u>2,704,887</u>
	<u>\$3,564,660</u>

At September 30, 2010, the carrying amount of AHI's deposits with financial institutions was \$205,265 and the bank balances were \$223,060. Bank balances were fully insured by the F.D.I.C.

NOTE L - CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2010 and 2009, is as follows:

	<u>2010</u>	<u>2009</u>
Medicare	34%	37%
Medicaid	9	8
Blue Cross	12	14
Other third-party payors	13	15
Patient	<u>32</u>	<u>26</u>
	<u>100%</u>	<u>100%</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2010 and 2009

NOTE M - BUDGETARY COMPARISON

Kansas statutes require that a fixed annual operating budget be legally adopted for the Hospital. All legal annual operating budgets are prepared using the modified accrual basis of accounting, modified further by the encumbrance method of accounting. Revenues are recognized when cash is received. Expenditures include disbursements, accounts payable, and encumbrances. Encumbrances are commitments by the Hospital for future payments and are supported by a document evidencing the commitment, such as a purchase order or contract. All unencumbered appropriations lapse at year-end. Actual expenditures for the year ended December 31, 2010, on the modified accrual basis of accounting and encumbrances were \$19,549,191 as compared to the legally adopted budgeted expenditures of \$43,228,122. Actual expenditures for the year ended December 31, 2009, on the modified accrual basis of accounting and encumbrances were \$19,146,513 as compared to the legally adopted budgeted expenditures of \$42,465,300.

NOTE N - DEFINED BENEFIT PENSION PLAN

The Hospital participates in the Kansas Public Employees Retirement System (KPERS), a cost-sharing multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, et seq. Substantially all employees of the Hospital are eligible to participate in KPERS following the completion of one year of service. KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS, 611 S. Kansas Avenue, Topeka, Kansas 66603-3803 or by calling 1-888-275-5737.

K.S.A. 74-4919 establishes the KPERS member-employee contribution rate at 4 percent of covered salary for employees hired prior to July 1, 2009, and 6 percent of covered salary for employees hired on or after July 1, 2009. The employer collects and remits member-employee contributions according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rate be determined annually based on the results of an annual actuarial valuation. KPERS is funded on an actuarial reserve basis. State law sets a limitation on annual increases in the contribution rates for KPERS employers. The employer rate established by statute for calendar years 2010 and 2009, is 7.14 percent and 6.54 percent, respectively. The Hospital employer contributions to KPERS for the years ended December 31, 2010 and 2009, were \$631,019 and \$451,035, respectively, equal to the statutory required contributions for each year.

NOTE O - SUBSEQUENT EVENT

On April 5, 2011, a ballot measure authorizing the Abilene, Kansas, Public Building Commission to issue revenue bonds on behalf of the Hospital in an amount not to exceed \$18,000,000 was approved by public vote. The Board of Directors intends to use the proceeds from these revenue bonds, along with an additional \$6,000,000 in long-term debt, to finance the construction of additions and renovations to the existing Hospital facilities.